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The relevance of post-Keynesian economic theory for socialist economies
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1. Introduction

One school of thought that defined an independent paradigm in economics is known as the post-Keynesian School (Eichner and Kregel (1975)). It concentrates almost exclusively on developed capitalist economies and all of its main propositions have been tested in that milieu. The question to be answered in this paper is: do post-Keynesian principles have any relevance for economies other than developed capitalist ones, in particular those economies usually labeled socialist or communist? This paper provides a simple test of the general applicability of post-Keynesian theory by applying some of the main post-Keynesian principles to the realities of contemporary socialist economies with regard to growth, income, distribution, prices and money. By socialist economies we understand here the Eastern-Europe type without considering the otherwise very important question of the true character of these economies and an adequate name for them.

2. Causes of Growth

The key role of investment in determining the level and rate of growth in economic activity was supported by J.M. Keynes' (1936) and Michael Kalecki's (1935) thesis that investments are a relatively independent variable. This tenet is fully incorporated in post-Keynesian theory which stresses that the investment determines savings and even the money supply, rather than the reverse. For, if the rate of investment is to increase, entrepreneurs must be confident enough of the future profitability of their own investments in order to commit themselves.

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to ownership and development of productive facilities (Asimakopulos (1986), p. 79). Savings adjust to increased investment activities as a result of both the multiplier and income distribution effects of changes in investment. The banking system accommodates credit and money supply to the manifest prospects of investment and thus plays an important but still consequential role in the investment process.

In other words, entrepreneurs' expectations about future profitability, which are inevitably influenced by political and psychological factors in addition to commercial ones, are the sole cause of investment. This approach is clearly related to capitalist economies where an independent social group exists that receives profits from property ownership and entrepreneurial activities and decides on their use. Does this approach have any relevance for socialist economies? Since in socialist economies there is no separate group of people owning capital and receiving profits, this question may seem unexpected. However, it will be argued here that this is a meaningful one, possibly with an affirmative answer.

If we accept that in contemporary socialist countries there exists a social group or elite comprising of the highest party and government officials, who make all major decisions concerning the economy including those on the share of investment in social product, the motivation and behavior of this group is of central importance. Keynes (1936) argued that the investment behavior of a capitalist class was ultimately governed by "animal instincts". The same type of behavior of a socialist elite depends mainly on something that could be called "ideological instincts". This term seems appropriate, because the share of investment in social product in a socialist economy does not depend on the personal consumer aspirations of the decision-making elite (the history of socialism documents that it is an independent, exogenously determined variable). The share of investment in a socialist economy depends mainly on the ideological strength and theoretical orthodoxy of the elite (which is itself influenced by the achieved level of economic and social development).
Stalin's regime was obviously not only theoretically orthodox and dogmatic, but also very strict in limiting the consumption of the majority of the population in order to achieve "accelerated industrialization". The same could be said of the Stalinist regimes in Eastern Europe in the fifties, Mao's China, Pol Pot's Cambodia etc. On the other hand, socialist leaders or elites who to a certain degree pursued a course of political liberalization and therefore were usually accused of "revisionism", were inclined to distribute the social product between consumption and investment in a more balanced way. Representative examples are contemporary Hungary, China and especially Yugoslavia whose politically quite unorthodox leader(s) in the last two decades almost reached the opposite extreme in the division of the social product. A relatively high standard of living in Yugoslavia together with a relatively low income per capita were only possible on the basis of mainly external investment (foreign credit) which recently led to the problems of a huge foreign debt, stagnation, nearly 100-percent annual inflation and a sharp decline in real wages.

Having in mind nineteenth century European capitalism, Keynes (1971, p. 11-13) wrote:

"Thus this remarkable system depended for its growth on a double bluff or deception. On the one hand, the labouring classes accepted from ignorance or powerlessness, or were compelled, persuaded or cajoled by custom, convention, authority and the well-established order of Society into accepting a situation in which they could call their own very little of the cake, that they and Nature and capitalist classes were co-operating to produce. And on the other hand, the capitalist classes were allowed to call the best part of the cake theirs and were theoretically free to consume it, on the tacit underlying condition that they consumed very little of it in practice. The duty of "saving" became nineteenth of a virtue and the growth of the cake the object of a true religion.

... I seek only to point out that the principles of accumulation based on inequality was a vital part of the pre-war order of society and of progress as we then understood it, and to emphasize that this principle depended on unstable psychological conditions, which it may be impossible to recreate. It was not natural for a population, of whom so few enjoyed the comforts of life, to accumulate so hugely."
If we now re-read this extraordinary passage but think of the twentieth-century Soviet Union instead of nineteenth-century Europe and exchange the word "capitalist class" for "socialist/communist elite", we will get an equally good explanation of the necessary conditions for growth of the socialist economy. Huge accumulation and diminishing consumption of the majority of the population are, and always were, the two unseparable and inevitable aspects of the industrialization process. This was very well recognized by Preobrazenski (1926, ch. II) in his formulation of the law of "socialist primitive accumulation" which revealed the "bluff or deception", as Keynes would say, of the "fast industrialization" period in the USSR.

In conclusion, economic history documents very well the thesis that the rate of growth of industrializing economies depends mainly on the behavior of the (narrow) social elite who monopolizes saving-investment decisions. The origin, structure and political persuasions of different social elites governing the process of growth are of great, but, strictly economically, secondary importance. What is of primary importance is their comparative efficiency, i.e. the velocity and stability of growth they induce.

It should be noted here that investments obviously are not the only factor of growth, although probably the most important one. Research on the influence and significance of other factors of growth in socialism, especially the neglected ones such as organizational factors (the so-called "x-efficiency"), would be an important undertaking. However, they were not considered here since the originality of post-Keynesian theory compared to traditional neoclassical theory lies mainly in the explanation of the rate of investment as a factor of growth.

3. Instability of Growth

Harrod (1939) proved that whenever investment decisions are carried out not by a single but by a number of individuals or institutions a potential instability of growth exists, since an
aggregate of independent individual investments in an economy is not necessarily equal to the total level of investment needed for the stable ("guaranteed", as Harrod would say) rate of growth. This statement is incorporated in the post-Keynesian explanation of the causes of growth instability in (liberal) capitalism where uncorrelated individual decisions on investment can hardly be expected to reach the necessary aggregate level of investment in the economy (Cornwall (1979), p. 20).

But what about investment in socialist economies? In principle, the decisions on the share of investment in net social product should be taken by the state planning authority. But a completely centrally planned economy is an abstract concept, although some socialist economies at certain periods were approaching it in reality (the USSR in the thirties, China in Mao's era, etc.). The latest direction of institutional change in Eastern Europe, however, documents that the decision on the share of investment does not take place at only one level of industrial management even in the most centralized economies. This is even truer for those socialist countries that allow for more decentralization and market mechanisms. In Yugoslavia, for example, the total share of investment is formed as an aggregate of a number of relatively independent decisions on investment on the company level (strongly influenced by the local bank, as well as government and party authorities). The sum of individual firms' investments in Yugoslavia, together with private investment in agriculture and small business, however, does not necessarily reach the aggregate level of investment needed for stable growth. This is very well documented by the instability of growth in Yugoslavia and the lacking capability of central planning organs to achieve fulfilment of their predictions in the form of five year plans (Horvat (1976), p. 42-48).

Thus the leaders of all socialist economies are confronted with a Faustian dilemma: either they centralize investment decisions making in order to achieve stable growth but eliminate incentives on the lower levels of the economic structure
and hence threaten growth, or they decentralize decisions on investment in order to increase efficiency and growth but risk disproportionality of macro-economic variables and hence threaten the stability of growth. The latest direction of institutional change in Eastern Europe shows that the second threat to growth is considered the less dangerous one. The relevance of post-Keynesian propositions is now immediately evident, since the consequences of decentralized decision making on investment are a post-Keynesian topic par excellence. The fact that individuals who take these decisions are not private owners and recipients of profits but representatives of state-owned firms, or even local party officials, does not change the substance of the fundamental growth problem: who or what guarantees that partial investment decisions needed to offer incentives reach exactly the necessary aggregate level? Mechanisms and institutions coordinating decentralized investments are quite different in socialist and capitalist economies but, nevertheless, perform the same economic task.

4. Income Distribution

A distinguishing characteristic of post-Keynesian theory is that the distribution of income is considered integral to the explanation of economic activity (Eichner and Kregel (1975), p. 1296) in a sense that the control over the rate of investment implies control over the distribution of income and the rate of profit (Pasinetti (1974), p. 113). Classical economists assumed a twofold class structure (workers and capitalists) and profits as the only source of investment. The simple post-Keynesian model based on these assumptions shows that a higher growth rate, given the same production techniques and money wage rate, means redistribution of income favoring profits at the expense of wages. If we allow for savings out of wages but also assume that the propensity to save out of profits is greater
than that out of wages, the assumption of a twofold class structure is shaken, but the main post-Keynesian hypothesis, as was shown by Kaldor (1956), still holds. In this case, a larger saving-investment share in profits (at the expense of consumption) today still means a larger profit share in national income (at the expense of wages) tomorrow. This is because of what lies behind the post-Keynesian delineation of income shares is not so much a distinction between social classes, as the distinction between quasi-contractual and residual forms of income (Kregel (1973), ch. 11). It is precisely this insistence on different forms of income, which does not have to correspond to the separate classes of population, that allows the generalization of the post-Keynesian statement on income distribution to include countries other than capitalist ones. This was already remarked by Eichner and Kregel (1975, p. 1299) although they do not seem to have elaborated on it any further:

"Indeed these conclusions (on the irrelevance of workers' savings for the functional distribution on quasi-contractual and residual forms of income - N.J.) apply to any economic system in which some one group, private and public, receives a residual share depending on the level of economic activities - and it is hard to conceive of any economic system without that characteristic."

In socialism, nobody receives a residual share. However, it has already been argued here that there is a social group that completely controls this residual share, which in the economic, but not juridical, sense of the word amounts to the same thing. Therefore, the fundamental classical and post-Keynesian contention that the necessary condition for larger future profits (accumulation) is current redistribution from consumption to saving/investment and from quasi-contractual to residual forms of income, holds for both capitalism and socialism. Due to enormous institutional differences, however, policies of growth and distribution are faced with different problems in the two systems. This could be documented by the classical problem of controlling aggregate demand.
A lot of evidence has lately been provided to show that credit and monetary policy is not sufficient for controlling demand and maintaining stable growth and high employment in developed capitalist countries (Cornwall (1983), ch. 12). For quite specific reasons this kind of policy is not efficient enough in socialist countries either. As is well known, in capitalism even the quasi-contractual forms of income, such as wages, could contain possible surpluses which could be saved, invested and returned to the wage earner in the form of profit. Such a possibility does not exist in socialism. Since they cannot invest their possible surpluses, workers in socialism are inclined to consume them completely and immediately. Hence, those surpluses have a much more direct and complete influence on aggregate demand in socialism than in capitalism. Empirical evidence for this statement is the phenomenon of demand, which is almost always larger than supply, as manifested in the famous shortages that are a common and constant feature of socialist economies (Kornai (1980)). A restrictive credit-monetary policy in those circumstances is of even less help than in capitalism, and a socialist state is forced to implement more direct policy measures, such as full control of prices and wages. In other words, every unplanned increase in the quasi-contractual forms of income, i.e. the increase of the real wage, is a greater threat to the stability of the socialist than of the capitalist economy, precisely to the extent that the propensity to save (and invest) out of wages is greater in the latter than in the former system. The ideological limit in the form of prohibition of any private investment has as its necessary consequence either the need to keep real wages always near existential needs (in "real socialism") or an incapability of controlling aggregate demand and hence inflation (in more decentralized countries with real wages not always under full control, as in Yugoslavia).

It should be noted here that the problem of optimal investment and consumption shares during the growth process is also dealt with in neoclassical literature (so-called "optimal growth paths"). The results of that approach, however, can hardly be compared to those achieved in a post-Keynesian analysis, since the
two theoretical traditions sharply differ in their initial assumptions, tools of analysis and view of economic reality in general.

5. Dual Character of the Economy

Post-Keynesian theory argues that the economies of developed capitalist countries consist of two different sectors - a corporative and a competitive one. The theory concentrates on the mark-up procedure by which prices are either dictated or negotiated in the dominant corporate sector (Kenyon (1979)). Since the whole socialist economy, or at least its dominant state sector, can be viewed as a huge, very well integrated corporate sector, USSR Ltd., as Nove (1978, p. 38) would say, the similarities with the capitalist corporate sector, as described by the post-Keynesian authors, are numerous: 1) in both sectors, prices reflect "mark-up over prime costs" where the height of the mark-up depends on the plans of those controlling the sector; 2) both sectors try to gain full control over prime costs (primarily raw materials and wages) by subordinating the raw material producers and by the control of real wages; 3) in both sectors prices are fixed at the level needed to finance planned investment expenditures; 4) both sectors are characterized by "administrative competition" (Nove (1978), p. 36) over the distribution of available resources; 5) in both sectors the response to a change in demand for the sector's products is a change of output and not of prices; 6) the main goal of governing groups in both sectors is stable growth over a long period, and all variables of the system (prices, income distribution etc.) are accommodated to serve this purpose. All of these similarities, needless to say, are realized in different institutional arrangements and show up in different forms, but they are still based on the same economic content. The explanation for these important similarities can be found in the fact that both systems belong to the higher stages of development of the industrial mode of production whose technology and organization of production force leading social groups, no matter what
their name is, what origin they have or political philosophy they follow, to provide answers to the same economic problems. The political and institutional differences, otherwise very important, are just of secondary importance here.

Although much better integrated than its capitalist counterpart, the state/corporate sector of contemporary socialist economies is not uniform. Deeper insights into the structure of "real socialist" economies provide evidence of the fact that the level of state control is not the same in all sectors of the economy, especially since the economic reforms of the sixties (Jankov (1981), p. 494; Bunic (1980), p. 164; Savcneko i Jeremcuk (1978), p. 50). It varies according to the central planners' opinions on the economic and social importance and priority of a particular sector. A steel mill in Eastern Europe would hardly have any problem with investment financing, but would hardly expect any freedom concerning product prices and product buyers either. The same does not always follow for a textile or furniture firm where the freedom for business moves is greater and a skillful manager (commercially oriented or with good political "connections") disposes of more diversified ways of promoting the firm's interests.

The existence of at least two different subsectors inside the state/corporate sector can be even better recognized in those specific socialist countries that allow for more decentralization and market. The dominant subsector is usually under more direct control of the government, has a monopoly position in the market and is characterized by self-investment or at least an absolute priority in investment financing. Another subsector, consisting of "light" industries, services, together with private agriculture and small-scale business, is much more exposed to market competition, prices vary significantly and investments are generally much less certain. A specific interplay of those two (sub)sectors provides certain dynamics to the more decentralized socialist eco-
nomic; but sometimes at the expense of the stability of growth (as argued above).

The existence of two different sectors within a socialist economy, even not so clearly recognized as in capitalism, has still one more important aspect. For a small and relatively open (even a socialist) country, world prices, which, according to post-Keynesians, are formed by the interplay of the corporate and competitive sector on a world-scale, are given. They cannot be significantly influenced from inside. This implies that the oil and food industries, for example, will be in a different position due to external factors, regardless of their internal characteristics. Thus, one cannot neglect the influence of world prices and the economic world order in general on internal matters of socialist economies.

All of this supports the thesis that the phenomenon of a dual character of the economy, stressed by the post-Keynesians, is relevant for socialist economies. The interplay of two differently organized sectors in a socialist economy enables the governing elite to pursue more elastic and adaptable policies and allows for the concentration of surpluses disposable for investment in those branches which are considered as the most important and propulsive ones. Thus, the dual character of socialist economies, although manifested in institutional arrangements different from capitalist economies, contributes to the same goal as it does in capitalism. Political and institutional factors which differentiate these two systems can hardly hide the similar economic substance they are based on.

6. Money and Credit

According to post-Keynesians, monetary authorities do not have complete control over the supply of credit in the economy and, hence, cannot effectively control aggregate spending. This is because the supply of credit provided by the banks accommodates the demand for credit created mainly by the dominant corporate sector. This endogenous theory of money, according to which the demand for investment and credit creates its own supply and not vice versa, is explained by specific relations and the interplay of interests between large corporations on the one side, and commercial and central banks on the other (Moore (1979)).
Recently, Gedeon (1985) has extended this thesis by arguing that there could exist non-bank sources of credit in the economy such as issuing and transferring bills of exchange and failing to meet debt obligations. Gedeon documents this thesis by a case study of the Yugoslav economy (!) which is, it seems, a paradigmatic example of an economy where the monetary authorities cannot control the money supply or, as Bajt (1982) says, where an "autonomous right of monetization" exists. Ujdenica (1983) has documented that the growth of mutual crediting, in the form of debt issued by buyers and accepted by sellers and different kinds of uncovered claims, is strongly negatively correlated to a severely restrictive credit and monetary policy. In other words, confronted with a restriction of the money supply, firms simply created their own "money". More than that, this endogenously created money is not only widely accepted in mutual transactions between firms, but also silently approved by monetary and state authorities!

The explanation for this lies in the specific characteristics of the Yugoslav economic system which allows companies a certain independence in the market (similar to capitalist economies) but, in the end, protects illiquid firms from bankruptcy and secures the basic right of employment and income, at least for those who already work (similar to socialist economies). Thus, market socialism, of which Yugoslavia is a representative example, is confronted with the almost incompatible goals of achieving macro-economic efficiency in the case of socially-owned but market-dependent firms, and guaranteeing the right to work and income at least to those who are already employed. One of the possible (even temporary) ways out of this paralyzing situation is to allow for an endogenously created money in the economy which hides and postpones social conflicts about but brings enormous inflation and elements of a monetary chaos. As Gedeon (1985, p. 219) concludes:

"Ultimately both the capitalist and the market-socialist economies must deal with the question of who is ultimately responsible for bank lending since in both economies chronic inflation is explained by the inability or unwillingness of monetary authorities or the state to prevent rival claimants for limited social resources from creating money to realize their target expenditures."
But Yugoslavia perhaps represents an exception among socialist countries with respect to monetary issues, and the question of relevance of post-Keynesian endogenous theory of money and credit for socialist economies in general still has be considered. The main proposition of that theory, which says that money is rarely a problem when there is a will to invest (at least in the dominant corporate sector), seems to hold for socialist economies also.

Planning authorities or governing groups who decide on the share of investment also have full control over financial institutions and, hence, money and credit. It is highly improbable that any particular investment project incorporated in the overall plan would be cancelled because of the lack of financial means alone. The aggregate level of investment, however, depends mainly on the "ideological instinct" of a narrow decision making elite (as argued above). So, if we take "ideological instincts" as given, they would easily result in an adequate amount of financial means for investment, similar to the way in which Keynesian "animal instincts" of the capitalist class usually effect the adequate money supply.

In principle, governing groups in socialism have a much more direct and efficient control over all elements of the economy and it seems that a strict credit-monetary policy would be quite sufficient a tool for controlling aggregate spending. But, in fact, this is only true for investment-spending in the dominant state sector. Other forms of spending, labor consumption above all, are not always under full control. It has already been argued in this paper that eventual surpluses in wages (above what are considered to be existential needs) are usually not saved but consumed. If in addition to this there consists a constant public pressure for the increase of real wages and also a conflict over the distribution of income between different groups of wage earners (which is usually resolved by an unplanned increase in some nominal wages), a typical post-Keynesian problem arises. Post-Keynesians argue that the conflict over the income distribution lies at the heart of inflation. What is needed in that situation is: "some binding political accord among major economic groups in the system which outlines the share of income each group is willing to accept (Eichner (1979),
p. 182). The conflict over income distribution in socialism, although not as visible as in capitalist democracies, is also resolved at the expense of monetary equilibrium. The important difference, however, is that this does not result in an increase of inflation (which officially does not exist), but in a way typical of socialist economies: an increase of all kinds of shortages. For, if money supply and hence demand are increased while prices are not allowed to adjust, shortages are a quite logical outcome.

In fact, the governing groups of socialist economies consciously decided that shortages were the less dangerous consequence (than inflation or unemployment) of the same fundamental problem of all industrial societies. Kornai (1979, p. 804) confirmed this when he concluded that in socialism "... Shortage plays a role similar to the problem of unemployment in the description of capitalism." Yugoslavia is obviously an exemption to this rule among the socialist countries, since its governing elite provided a typical "capitalist" solution according to which inflation and unemployment are more acceptable than shortages and unmotivation. But this only confirms the view that there exists a fundamental problem common to all industrialized societies, namely the problem of distribution of limited social resources and income between rival social claimants which can be resolved in different ways depending on the economic and political philosophy of their governing elites.

7. Conclusion

An attempt to test the general validity of post-Keynesian theory by applying a few of its main propositions to the realities of contemporary socialist economies provided results with affirmative answers. The problems of growth, income distribution, prices and money in socialism could be approached on the basis of post-Keynesian theory. The usefulness of this result is of a twofold nature. First, certain new and original insights in the way of operation of socialist economies could be achieved. Second, post-Keynesian theory showed a potential general applicability that makes possible research on the industrial mode of production in all of its contemporary, politically and historically diversified manifestations.
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